Retail Pricing Strategies

What Affects Pricing?

- Consumer Factors
  - *Supply/Demand*
  - *Price Elasticity of Demand*
    - *Sensitivity of buyers to price changes*
- Govt. Factors – FTC
- Mfrs., Wholesalers, Suppliers
- Competition
- Strategy Variables
  - *Target audience*
  - *Profits*

Pricing Strategies

- Demand-oriented
- Cost-oriented
- Competition-oriented

Demand-Oriented

- Estimate how much customers will buy at various price levels
  - Set prices to achieve sales goals
- Determine prices acceptable to target market
  - Demand ceiling
  - Demand floor
- Psychological Pricing
  - Price/quality relationship
  - Odd pricing

Zone Pricing:

"Refining companies actually map out areas and charge dealers different wholesale prices based on secret formulas that often factor in location, the area's affluence or simply what the market will bear."

Wholesale Prices:

Ct.: Berlin $0.95
Greenwich 1.01
NY: Albany $0.98
NYC 1.12
Northern CA: Pleasanton $1.20
Palo Alto 1.35

Secret Formulas Set the Prices For Gasoline

By Alexei Barrionuevo
Staff Reporter of The Wall Street Journal

At Bill & Mitch's Exxon station in Potomac, Md., regular gasoline costs about $1.72 a gallon. Si cents a gallon more than at Exxon stations in southern Maryland. And in Laurel, Md., motorists have been paying up to five cents more a gallon at Tommy Martin's Shell station than at Art and Charlotte Harnek's Shell about two miles away.

A key reason? Zone pricing, an increasingly common practice that boosts oil-company profits. Refining companies actually map out areas and charge dealers different wholesale prices based on secret formulas that often factor in location, the area's affluence or simply what the local market will bear.

And yes, it's perfectly legal.

But as gasoline prices soar and former competitors merge into huge companies, the practice has drawn the ire of dealer groups and government officials in California, Oregon, Connecticut and Maryland. Some of them are now pushing to make zone pricing illegal, or at least to establish clear rules for its use.

The Federal Trade Commission, in reviewing the merger of Exxon Corp. and Mobil Corp. last year, noted that big oil companies often set their prices based on competitors' prices rather than their own costs. It called the practice "an earmark of oligopolistic market behavior." Though it eventually approved the merger, the agency has con-

Zoning at Work

The wholesale prices that refining companies charge franchise dealers in various markets for regular unleaded gasoline.

Connecticut
Six-cent spread
- LOW: Berlin $0.95
- HIGH: Greenwich 1.01

New York
14-cent spread
- LOW: Albany 0.98
- HIGH: New York City 1.12

Northern California
15-cent spread
- LOW: Pleasanton 1.20
- HIGH: Palo Alto 1.35

Sources: Oasis/Lundberg Survey; Automotive Dealers and Refiners Association; Petroleum Marketers Association of America; Service Stations and Repair Shops, California Service Station and Automotive Repair Association

Cost-Oriented

- Takes into account the cost of merchandise, retail operating expenses, and desired profits
- Markup covers operating expenses and profits
  - *Markup = Selling price (retail price) – Cost of Goods*

Entrée Economics

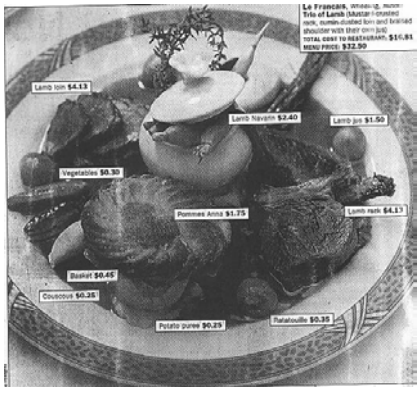
- 300% solution: Many independently owned restaurants aim for an overall food markup of 300% or 4X the cost of the raw ingredients
- But, you might see a 500% markup on a grilled vegetable plate (and pay $9) and only a 200% markup on a tenderloin meal (and pay $25)

Pinot Bistro, Los Angeles

Grilled Pork Chop with white beans, pancetta, escarole, and assorted olives

Total Cost to Restaurant: $5.67

Menu Price: $19.95

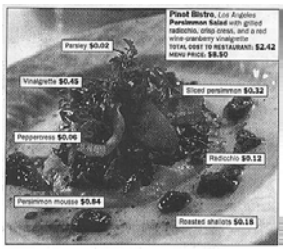


Le Francais, Wheeling, Illinois

Trio of Lamb (mustard-crusted rack, cumin-dusted loin and braised shoulder with their own jus)

Total Cost to Restaurant: $16.81

Menu Price: $32.50



Pinot Bistro, Los Angeles

Persimmon Salad with grilled radicchio, crisp cress, and a red wine-cranberry vinaigrette

Total Cost to Restaurant: $2.42

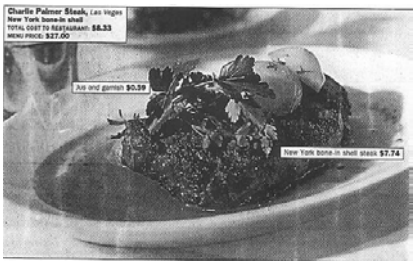
Menu Price: $8.50

Charlie Palmer Steak, Las Vegas

New York bone-in shell

Total Cost to Restaurant: $8.33

Menu Price: $27.00



Figuring Out the Tab

We asked six restaurants to tell us the ingredients of one of their entrees, and what they cost the restaurants wholesale. Then we bought the ingredients at the grocery store. The results:

RESTAURANT	DISH	INGREDIENTS	MENU PRICE	GROCERY STORE PRICE	WHOLESALE PRICE
Carmine's New York, NY	Zuppa di mussels	1 pound mussels with tomato sauce	$12	$3.15	$2.25–$2.50
Heaven on Seven Chicago, Ill.	Grilled Louisiana Gulf shrimp and Andouille sausage on bed of white rice (comes with a choice of cup of soup, gumbo or salad)	6 shrimp (about 6.5–7 ounces), 2.5 ounces andouille sausage, 6 ounces white rice, plus sauce and seasoning, and 1 cup of soup	$18.95	$9.00	$6.39
Grill 23 and Bar Boston, Mass.	Grilled swordfish	12 ounces swordfish	$24.50	$9.00	$6.50–$7.50
Docks New York, NY	Grilled tuna with steamed red potatoes and coleslaw	10 ounces tuna, 8 ounces potatoes, 5 ounces coleslaw	$20.50	$8.15	$6.55
Pinot Bistro Los Angeles, Calif.	Farm chicken with a roasted garlic glaze and Pinot fries	12 ounces chicken, 10 ounces french fries	$15.95	$3.00	$4.08
Tennessee's Real BBQ Real Fast Framingham, Mass.	Slab of Memphis ribs	2.25–2.5 pounds of pork ribs, 5 ounces cucumber salad, 5 ounces beans, cornbread, sauce and seasonings	$18.95	$11.60	$5.94

Cost Example

- Retailer buys a TV for $200 and wants to sell if for $300
  - Markup in $: $300 200 = $100
  - Markup % on Retail = 100/300=33%
  - Markup % on Cost = 100/200 = 50%

Markup

- Markup% (at retail)
  - $\frac{\text{Retail Selling Price – Merchandise Cost}}{\text{Retail Selling Price}}$
- Markup % (at cost)
  - $\frac{\text{Retail Selling Price – Merchandise Cost}}{\text{Merchandise Cost}}$
- Merchandise cost
  - What the retailer pays the mfr. (unit costs, freight costs, less discounts)

Initial Markup

- Initial value of merchandise less the cost of the merchandise

Ex. A bike retails for $100 and costs the retailer $60

- initial markup is $40 (100-60)

- 40% of retail (40/100)

- 66% of cost (40/60)

Maintained Markup

- Based on the actual price received for the merchandise less the cost of the merchandise

Ex. If the bike sells for $80, maintained markup is $20 (original retail price was $100)

Maintained markup on retail is 20% (20/100)

How do you determine the initial markup?

- Initial Markup % (at Retail)

$$\frac{\text{expenses + profits + reductions}}{\text{planned sales + reductions}}$$

Ex. A florist plans sales of $200,000, has operating expenses of $45,000, desires a profit of $35,000, and is expecting reductions of 20% of sales (or $40,000)

$$\text{Initial markup} = \frac{45{,}000 + 35{,}000 + 40{,}000}{200{,}000 + 40{,}000} = 50\%$$

Maintained Markup %

- $\frac{\text{Expenses + Profits}}{\text{Net Sales X 100}}$

Florist:

$$\frac{45{,}000 + 35{,}000}{200{,}000(100)} = 40\%$$

Florist Ex. (cont.)

- If flowers cost $8.00/dozen, what should the florist charge for the flowers (retail selling price)? Assume a 50% markup on retail

Retail Selling Price = merchandise cost / 1- markup

So: $8.00 / 1-.5 = $16.00

Retail Selling Price = Cost of Merchandise + Markup

Converting Markup from Retail to Cost

- *Markup % on Cost = Markup % on Retail / 100% - Markup on Retail*

Ex. If markup on retail is 18%, what is the equivalent markup on cost?

Answer: .18 / 1-.18 = .219

Converting Markup from Cost to Retail

- *Markup % on Retail = Markup on Cost / 100% + Markup % on Cost*

Ex. If markup on cost is 36%, what is the equivalent markup on retail?

Answer: .36 / 1.36 = .26

What Should you Pay for Merchandise?

You are considering vendors for private label shirts. You would like the retail price of the shirts to be $25.00. Your markup objective is 45% on retail. What is the highest price you can pay to meet this objective?

Retail Selling Price = Cost of Merchandise + Markup

$25 = X + $11.25
100%= 55% + 45%

So: 55% of $25 = $13.75

Determining the Most you Can Pay

- A buyer for men's clothing is seeking sport coats to retail for $125. The markup objective on retail is 48%. What is the most a buyer can pay a supplier for the jackets?

$125 (100%) = X + (48%)
X = 52%

52% of $125 = $65.00

Setting the Retail Price

- A gift shop owner must pay a vendor $6.00 for a photo album and she wants to maintain a 60% markup on retail. What should she charge for the album?

Retail Selling Price = Merchandise Cost / 1 Markup

$6.00 / 1- .6 = $15.00

Pricing Strategies

- Everyday Low Pricing
- High/Low Pricing
- Odd Pricing
- Leader Pricing
- Multiple Unit Pricing/Price Bundling
- Price Lining
- One-Price Policy

Markdowns

- Reduction in the initial retail price

Markdown as % of net sales =

$$\frac{\text{\$ amount of markdown}}{\text{net sales}} \quad X\ 100$$

Ex. You bought 100 sweaters and 80% sell at $50 each while the remainder sell at $30 each

Ans.: Markdown amount – 20 sweaters were marked down $20 each so $20 X 20 = $400

Net Sales Revenue is (80 X $50) + (20 X $30) = $4600

Markdown % = $\frac{\$400}{\$4600}$ X 100 = 8.69%

Advertising Markdowns to Consumers

Markdown % (of original retail value) =

$$\frac{\text{\$ price reduction per unit}}{\text{original price per unit}} \quad X \quad 100$$

Ex. A sweater retails for $50 and is marked down to $30. What is the markdown %?

20/50 X 100 = 40%